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California Bank v. DelPonti

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- **Guarantor's waiver of defenses is limited to legal and statutory defenses expressly set out in the agreement.**

California Bank v DelPonti (2014) 232 CA4th 162

The development of a 70-unit townhome project by Five Corners Rialto, LLC (Five Corners), funded by a construction loan by Vineyard Bank (Bank) and guaranties from Thomas DelPonti and David Wood (Guarantors), was split into two phases to be built by Advent, Inc., a general contractor. Toward the end of the first phase, Bank stopped funding approved payment applications, which prevented the completion and sale of the units and ultimately led to defaults on the loan. Bank and Five Corners agreed to allow Advent to finish the first phase of the projects so that the units could be sold at auction, and Bank would pay Advent, which would pay its subcontractors out of its pocket in the meantime.

Bank foreclosed on Five Corners and filed an action against Five Corners and Guarantors for the deficiency following the trustee's sale under the deed of trust. Advent sued the developer and Bank for restitution of the amounts it paid its subcontractors out of pocket. The trial court awarded Advent judgment on its breach of assigned contract and promissory estoppel claims and found Bank had breached its loan contract, thus exonerating Guarantors. Bank appealed.

The Fourth District Court of Appeal affirmed the trial court's judgment. The partially published decision included the court's affirmation of the judgment in favor of Guarantors. The court found that substantial evidence supported the trial court's decision because Guarantors performed as expected of them in accordance with their new agreement with Bank. Bank argued that Guarantors' waiver of their defenses under the guaranty agreements precluded judgment in their favor, but the court disagreed. Although guarantors may waive rights and defenses, a guarantor cannot be liable for unlawful contracts or contracts that conflict with public policy. Bank's own misconduct resulted in predefault waiver, not expressly waived in the guaranty agreement, and [CC §2856](#) did not permit lenders to enforce predefault waivers when it would result in the lender's unjust enrichment and profit from its own fraudulent actions.

The court held that a guarantor's waiver of defenses was limited to legal and statutory defenses expressly set out in the guaranty agreement and did not waive all defenses, especially equitable defenses like unclean hands. Bank had a duty of continuous good faith and fair dealing to Guarantors, which was not waived. Public policy precluded an interpretation that the agreement waived all defenses.

THE EDITOR'S TAKE: My first reaction to this opinion was to assume that it constituted merely another round in the ongoing battle between creditors and debtors as to what can be collected on a loan, and that it hardly signified the end of any particular battle.

This feature of a long-running fight started long ago, when lenders realized that borrowers often cannot pay back their loans that are due, meaning that the lenders needed some mechanism that made the promises of repayment that they received more enforceable. Requiring the debtor to post security, or having a related third person (e.g., the debtor's mother) who was richer than he furnish an additional promise to pay if he did not (*i.e.*, guaranteeing the debt), always makes a creditor feel considerably more secure.

While such an arrangement may be fine for a lender, it hardly appeals to a judge, who does not always find it morally gratifying to make a surety pay an obligation that she had not personally incurred. The judges responded to suretyship arrangements by treating sureties as “favorites” of the law, who needed to be carefully protected against the folly of their promises. See, e.g., [CC §§2809](#) (a surety's obligation should not be more burdensome than her principal's), [2810](#) (she is not liable if her principal isn't), [2819](#) (she is exonerated if the main obligation is altered), and [2845](#) (she can make the creditor proceed against the debtor first).

Of course, lenders would not take well to the concept that sureties might not have to pay debts that they had solemnly promised to pay, or that their lenders should owe them any additional responsibilities. So lenders began to insert in their guaranties provisions requiring their sureties to waive all of the protections that the judges had given to them.

The judges, of course, responded by reading these waivers as narrowly as possible to minimize their effectiveness and to leave the sureties as cushioned as possible. See, e.g., *Union Bank v Gradsky* (1968) 265 CA2d 40; *Cathay Bank v Lee* (1993) 14 CA4th 1533, reported at 16 CEB RPLR 198 (May 1993).

That development led the lenders to turn to the legislature to make their waivers more effective. See [CC §2856](#), providing that all the suretyship defenses in [CC §§2787–2855](#) and the antideficiency provisions ([CCP §§580a, 580b, 580d, and 726](#)) were waivable, along “with any other rights and defenses.”

But the judiciary then found a way to make even a guarantor's broad statutory waiver narrower. See *WRI Opportunity Loans II, LLC v Cooper* (2007) 154 CA4th 525, reported at 30 CEB RPLR 190 (Nov. 2007) (waiver did not include usury defense). That led me to believe that the next volley in the match might come from the lenders, who would seek to induce their legislative friends to validate even broader waivers to overcome the newer hurdle.

But I was wrong in that prediction: The next shot has come from the judges, who have decided that broader waivers by guarantors will not be sufficient to protect their lenders from misstatements they made during the workout process. Saying "I will not go after a deficiency judgment if you get the contractors to reduce their construction bills"—if the statement was intentionally false—will exonerate the accommodating guarantor, *even if all of the appropriate waivers are in the guaranty*.

That makes it considerably harder to conclude that a more extensive waiver is all a lender needs to counter this latest judicial setback, with or without legislative assistance.

This stymie may be the end of the battle in the standoff between creditors and guarantors. Although a full waiver of defenses is broadly tolerated by the *Restatement (Third) of the Law of Suretyship and Guaranty*—"Each rule in this Restatement stating the effect of Suretyship status may be varied by contract between the parties subject to it" (§6)—the Restatement then goes on to comment that "The freedom of contract afforded by this section is subject, of course, to general doctrines of contract law such as good faith and unconscionability that protect against overreaching and abuse." *Restatement §6, Comment b*. In particular, the Restatement provides that a fraudulent or material misrepresentation by the creditor can void the surety's assent. *Restatement §12*.

In *DeIPonti*, the court of appeal held a guarantor's waiver did not include allowing the lender "to profit from its own fraudulent conduct." That position appears to fit right in to the Restatement doctrine that this is as far as a suretyship waiver can go, no matter how adroitly it is worded.—*Roger Bernhardt*